

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF ILLINOIS

IN RE:)	
)	
GREGORY A. JONES and)	No. 03-84129
CINDY K. JONES,)	
)	
Debtor.)	

OPINION

This matter came before the Court for trial to determine the value of the residential real estate owned by Gregory A. Jones ("DEBTOR") and Cindy K. Jones (jointly referred to as "DEBTORS"). The DEBTORS have filed a Chapter 13 plan that proposes to strip off, as entirely unsecured, the second mortgage held by Associated Bank (the "BANK"). The first mortgage is held by Associated Loan Services and had a petition date balance of \$79,060.19. No evidence of any other liens was introduced at trial.

Junior mortgages may be stripped off through confirmation of a Chapter 13 plan where the fair market value of the property is less than the amount of senior liens so that there is no equity to secure the junior mortgage. *In re King*, 290 B.R. 641 (Bankr.C.D.Ill. 2003). If the junior mortgage is secured by any equity at all, it may not be stripped off or modified pursuant to Section 1322(b)(2) of the Bankruptcy Code.

The DEBTORS valued the property in their bankruptcy schedules at \$79,000.00. An expert appraiser testified for each party. Proving the maxim that appraising is art, not science, the opinions differ dramatically. The DEBTORS' appraiser valued the property at \$76,000.00, while the BANK'S appraiser concluded \$105,000.00 was the correct value. The Court must attempt to reconcile these two divergent opinions.

The property is located in an unincorporated area of Peoria County at 938 Paddock Road. Paddock Road is located in a small residential development consisting of approximately 16 streets of developed residential housing, bisected by Farmington Road, a two lane road with a variety of commercial businesses mixed in with single family residences. The Paddock Road area is west of the City of Peoria and not contiguous therewith. It lies north of and adjacent to the village of Bellevue (pop. 1,887). It is approximately two miles west of the village of West Peoria (pop. 4,762) and several miles north of the larger town of Bartonville (pop. 6,310).

The house, built in 1977, is a Wausaw style prefabricated ranch home, consisting of three bedrooms, one and one-half bathrooms, a living room, dining room and kitchen, totaling 1,248 square feet. It has a basement and a two-car garage below the main floor living area. The property is also improved with a three-car detached garage measuring 26' by 36', built in 1995. The driveway is unpaved. The street on which the house is located has no curbs or gutters and no sidewalks.

Two major problems exist that negatively affect the property's value. First, the detached garage encroaches across the property's boundary line by seven inches. The BANK'S appraiser testified that the most likely remediation method, in his opinion, would be to tear down approximately one-third of the garage. He estimated the cost of this corrective project at \$5,000.00. His opinion was the sole evidence on this issue.

Second, the property has a water problem that has caused damage to the concrete block foundation and, possibly, to the walls and floor on the main level of the house. The

DEBTOR testified that the south basement wall, which serves as a side wall for the built-in garage, is “sinking and cracking.” In his report, the appraiser for the BANK notes “some slilage (sic) of block” and further notes dampness in the garage.

The DEBTOR testified that the dry wall in the master bedroom is cracking and that the floor is “falling in.” Both appraisers noted the cracks in the bedroom and bathroom walls, which the BANK’S appraiser characterized as minor. The bathroom floor is shown to have sunken away from one wall in a photograph taken by the BANK’S appraiser, which he characterized as “minor settlement.” The DEBTORS’ appraiser had no opinion as to whether the wall and floor problems were due to natural settling or to the more serious foundation damage due to water. The BANK’S appraiser testified that, in his opinion, the lot needed to be regraded in order to redirect the flow of rainwater and a culvert needed to be built. He estimated the cost of this remediation work at \$11,900.00. There was no other evidence introduced on this point. The subject property must be valued assuming an “as is” sale, with its encroachment and water problems unremediated, and the value adjusted accordingly.

Both appraisers qualified as experts able to render an opinion as to the value of the property. Their experience is quite different, however. The DEBTORS’ appraiser, Charles Hemmer, is recently retired or semi-retired. He spent thirty years as a realtor/broker and was certified by the State of Illinois as an appraiser, although his certification expired on September 30, 2003, and has not been renewed. He performed about one hundred twenty-five (125) appraisals in 2003. He works with Jim Black, who he is training as an appraiser. The Court found Mr. Hemmer’s testimony to be credible and candid.

The BANK'S appraiser, Robert Rhodes, has no background as a realtor/broker. He is a certified Real Estate Appraiser in Illinois. From 1973 to 1985, he was chief appraiser for United Federal Savings Bank. Since 1985, he has owned and operated his own private appraisal business, averaging, according to his curriculum vitae, approximately 500 appraisals per year. He testified he performed two or three appraisals for the BANK in 2003. He denied knowing what the balance of the two mortgages was when he performed his appraisal.

The sales comparison approach is the most reliable method for appraising the value of single-family residential real estate. Miller and Gallagher, Residential Real Estate Appraisal 232 (3rd ed. 1998). The most important factors for determining the validity of comparable sales data are that (1) the characteristics of the comparable property are similar to the subject property, (2) the location of the comparable property is relatively close to the subject property, and (3) the date of sale of the comparable property is close to the valuation date. *Id.* at 233. The preferred location for comparable properties is the immediate neighborhood or subdivision where the subject is located. *Id.* at 233. Comparable sales within six months of the valuation date for the subject property are preferred, although in a stable market or where sales activity is low, a period of one to two years is acceptable. *Id.* at 234. Where only one of two competing appraisals is based upon recent comparable sales near the subject property's location, a court may reject the other appraisal in its entirety. *In re Zobenica*, 109 B.R. 814, 820 (Bankr.W.D.Tenn. 1990).

When a court is presented with two competing appraisals of single-family residential real estate, each made by a qualified appraiser, stating widely divergent values, a suspicion

is raised about the validity of one or both of the appraisals, and a heightened level of scrutiny is appropriate. The DEBTORS' appraiser used three comparable sales and the BANK'S appraiser used six different ones. Of these nine comparable sales, only one is in the same subdivision as Paddock Road. That is the Autumn Lane property, used only by the DEBTORS' appraiser, which is located four blocks from the subject property.¹ The only other comparable sale used by either appraiser that is reasonably close to the subject, is the Country Lane property, which is located about eight blocks from the subject in an adjacent subdivision just west of the Paddock Road subdivision.² The Country Lane comparable was also used only by the DEBTORS' appraiser and not by the BANK'S appraiser. The Autumn Lane property sale occurred on July 17, 2003, and the Country Lane property sold on November 14, 2003, both within the preferred six month period of the valuation date applicable here of August 29, 2003, the date of the bankruptcy filing.

Of the six comparable sales relied upon by the BANK'S appraiser, five are located in the town of Bartonville and each is three to four miles from the subject property. His sixth comparable, 5721 Sioux Trail, is located just north of Bartonville, about two miles from the subject, with the village of Bellevue lying between this property and the subject. This Court does not believe that the six comparables used by the BANK'S appraiser are valid comparable sales. Those properties are neither in the same subdivision as the subject, nor in an adjacent subdivision. They are not in the adjacent village of Bellevue. They are in, or

¹ The house at 1738 N. Autumn Lane consists of 1,040 square feet plus a basement, with three bedrooms on the main floor and a fourth bedroom in the basement. It sold for \$65,000.00 on July 17, 2003. The Multiple Listing Service information sheet stated the property "needs work."

² The house at 921 N. Country Lane consists of 969 square feet plus a basement and an oversized two car garage with a workshop area. The house was fully updated prior to sale with a new roof, new windows, siding, cabinets, carpeting and a partially finished basement with recreation room. It sold for \$89,000.00 on November 14, 2003.

near, the much larger town of Bartonville. Demographic data from the 2000 census indicates that the median home value in Bartonville is \$73,400.00, while the median home value in Bellevue is \$59,900.00. Given the subject's proximity to Bellevue, not Bartonville, Bartonville properties are not a valid standard for comparison, any more than properties in the City of Peoria would be.³

At trial, the BANK'S appraiser made no effort to justify or explain his use of Bartonville comparables. More significantly, he gave no explanation for his failure to use the two recent sales that meet all the accepted criteria for a valid comparable, those being the properties on Autumn Lane and Country Lane. In this Court's view, his failure to use those two comparable sales is inexplicable and indefensible, and it casts grave doubt on his methodology and the validity of his appraisal. On direct examination, the BANK'S appraiser noted some differences in age, square footage and the lack of an additional, detached garage between the subject property and those on Country Lane and Autumn Lane. However, those same differences are present as to the Bartonville properties that he relied upon. Given that no two properties are identical and that it is accepted methodology to adjust for the value differential caused by different property characteristics, his testimony in this regard was highly curious and entirely unpersuasive. The only reasonable conclusion to be drawn is that the BANK'S appraiser chose not to use the Autumn Lane and Country Lane sales because they did not support the value conclusion that he sought to establish, i.e., a value of \$105,000.00.

³ A four-mile radius from the DEBTORS' home would include a large portion of the City of Peoria and all or most of the separately incorporated village of West Peoria. In this Court's view, a comparable sale located four miles away in Bartonville is no more valid than would be a comparable sale the same distance away in Peoria.

The BANK criticizes the third comparable used by the DEBTORS' appraiser, located at 18312 W. Farmington Road, which the evidence indicated is approximately eleven miles from the subject. The Court agrees that the distance is too far for it to be a valid comparable.⁴ However, since its sale price of \$74,000.00 is close to the average of the sale prices for the Autumn Lane and Country Lane properties, it appears that the effect of the Farmington Road sale on the appraised value of the subject at \$76,000.00 was negligible. In addition, the DEBTORS' appraiser, an experienced real estate salesman, testified that, in its present condition, he would list the subject property for sale in the high \$70's and expect it to sell in the low \$70's. This corroborates the value stated on his appraisal.

The BANK'S appraiser also used a replacement cost approach. Both appraisers testified, however, that the sales comparison method is the best method for appraising the fair market value of a single family residence. In addition, his cost approach failed to take into account that the DEBTORS' house is prefabricated, which is less expensive to build than "stick" construction. Even though the BANK'S appraiser testified that the cost to remediate the garage encroachment and water problems present on the DEBTORS' property was estimated to be \$16,900.00, he used a deduction of only \$10,000.00 when adjusting his comparables for these differences. This discrepancy was unexplained.

For all of these reasons, this Court will disregard and place no weight on the opinion of value expressed by the BANK'S appraiser. The Court is of the opinion that the issue

⁴ The questioning of the expert witnesses by the BANK'S attorney reflected an assumption that a distance of five miles is the standard for a valid comparable sale based on proximity to the subject. Neither appraiser testified that this distance is an accepted industry standard. In this Court's experience and common sense, in all but the least densely developed areas, a distance of five miles is much too far for valid comparable sales. It appears that the BANK'S attorney picked this figure because the comparables of the BANK'S appraiser were all within five miles, while one of the comparables of the DEBTORS' appraiser was not.

should be determined by the opinion of value given by the DEBTORS' appraiser. Accordingly, the Court finds that the value of the DEBTORS' real estate at 938 Paddock Road, as of August 29, 2003, is \$76,000.00. Because the first mortgage balance of \$79,060.19 is greater than the determined value, the BANK'S second mortgage is wholly unsecured and may be stripped off in this Chapter 13 proceeding. The plan should be confirmed. The BANK will have only an allowed unsecured claim for its second mortgage balance. The lien avoiding effect of strip-off is conditioned upon the DEBTORS' successful completion of the plan and receipt of a discharge in Chapter 13. If the plan is not completed, the BANK'S second mortgage will remain in place as a lien against the real estate. The BANK is not required to release its lien at this time.

This Opinion constitutes this Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate Order will be entered.

Dated: February 5, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

Copies to:

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Michael D. Clark, Trustee, 401 Main Street, Suite 1130, Peoria, Illinois 61602
U.S. Trustee, 401 Main Street, Suite 1100, Peoria, Illinois 61602

UNITED STATES BANKRUPTCY COURT
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IN RE:)
)
GREGORY A. JONES and) No. 03-84129
CINDY K. JONES,)
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Debtor.)

ORDER

For the reasons stated in an Opinion filed this day, IT IS HEREBY ORDERED that, having determined that the value of the real estate located at 938 Paddock Road is \$76,000.00 as of the petition date, the Chapter 13 Plan filed by the Debtors is confirmable and should be and hereby is confirmed; the Objection to Confirmation filed by Associated Bank is denied. The Debtors shall submit a Confirmation Order within fourteen (14) days.

Dated: February 5, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

Copies to:
Gregory A. and Cindy K. Jones
Gregg W. Bittner
Faiq Mihlar
Michael D. Clark
U.S. Trustee